

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0206
Gross Income Tax and Adjusted Gross Income Tax
For the Years 1998-2001**

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ISSUES

I. Adjusted Gross Income Tax- Net operating loss elections

Authority: Ind. Code § 6-3-2-2.6; 45 IAC 3.1-1-9; I.R.C. § 172

Taxpayer protests the Department's disallowance of an election by taxpayer to forgo net operating loss carrybacks.

II. Gross Income Tax-Applicability

Authority: Ind. Code § 6-2.1-1-2.

Taxpayer protests the imposition of gross income tax with respect to the proceeds from the sale of a parcel of real estate.

STATEMENT OF FACTS

Taxpayer is a corporation engaged in managing several businesses in Indiana and other states. For fiscal year 1997, taxpayer had incurred a net operating loss for those businesses subject to Indiana taxation, but not for its entire consolidated group for federal purposes. However, the federal pro forma return submitted by taxpayer did not indicate that taxpayer had elected to forego carryback of its losses. Taxpayer then used the net operating loss on its returns for 1998, 1999 and 2000.

During 2000, taxpayer also sold a piece of real estate located in Indiana for a substantial sum of money. However, taxpayer listed the piece of property as being sold for a considerably lower sum of money. The difference, according to taxpayer, was that expenses for depreciation and losses were booked against the real estate for accounting purposes.

As a result of the audit, the Department found that taxpayer should have carried its net operating loss back to 1994, 1995 and 1996 prior to any application for years after 1997. The Department

further found that the taxpayer should have used the gross proceeds from the sale of its real estate as opposed to the net proceeds. Taxpayer protested these issues, and accordingly this letter of findings results.

I. Adjusted Gross Income Tax- Net operating loss elections

DISCUSSION

Taxpayer argues that its net operating losses should be carried forward. In particular, taxpayer argues that its failure to check the relevant box on its federal pro forma return was inadvertent, and therefore the election should be permitted to be made.

However, taxpayer's failure to elect was greater than merely this oversight. Ordinarily, the federal election controls the state election. 45 IAC 3.1-1-9. On the corporate tax return, Schedule IT-20NOL, is a box that can be checked if a taxpayer has a net operating loss for a given tax year for state purposes but not for federal purposes. However, the box for making the election with respect to the net operating loss was not checked. The act of checking the relevant box constitutes the election in question. Conversely, failure to check the box is not an election. Taxpayer, by failing to comply with the requirements to make a timely election to waive the carryback of its losses, is subject to carryback of its losses.

Taxpayer also cites to a Department letter of findings for the proposition that the Department is willing to overlook innocent mistakes by a taxpayer. In that letter of findings, the taxpayer had a net operating loss carryover that was not shown on a federal pro forma return after the taxpayer had merged with another company. The auditor treated the net operating loss as being eliminated by the merger, which would have ended any net operating loss carryover for Indiana. However, it was determined that the successor corporation was entitled to continue using its net operating loss carryovers for federal purposes, and accordingly the taxpayer's return was proper in that respect.

Unlike the corporation in the letter of findings cited by taxpayer, where the corporation was compliant with state and federal law, the failure to make an election to not carry back its net operating losses was non-compliance with state and federal law. Such non-compliance denies the election. Further, permitting the election to waive carrybacks in this case where the taxpayer does not properly make the election on the initial return would be a license to permit future taxpayers to not make the election, and then allow them to make (or not make) the election if circumstances permitted at a later time, renders the phrase "irrevocable for such taxable year" meaningless. I.R.C. § 172(b)(3).

Taxpayer further maintains that the years prior to fiscal year 1997 were loss years, and thus a carryback would have been superfluous. First, taxpayer's returns actually show a net profit for Indiana purposes during the first two of those prior years. Second, if taxpayer had net operating losses from years prior to 1994 that were not utilized in those three years, then an election to waive a carryback would have been a functional nullity – the loss could realistically only be carried forward, regardless of any election. As a result, taxpayer's net operating losses are to be carried back in accordance with Ind. Code § 6-3-2-2.6.

FINDING

Taxpayer's protest is denied.

II. Gross income tax- Applicability

DISCUSSION

Taxpayer has also protested the imposition of gross income tax with respect to the sale of a parcel of real estate. In particular, taxpayer protested the imposition of tax with respect to the full sale price as opposed to the net sale price. Under Ind. Code § 6-2.1-1-2(a)(3), all proceeds from the sale of real property in Indiana are subject to tax, subject to certain deductions and exemptions not at issue here. Accordingly, taxpayer's protest must be denied.

FINDING

Taxpayer's protest is denied.